

**DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 97-0043SLOF
Indiana Corporation Income Tax
For The Tax Periods: 1990 through 1992**

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ISSUES

I. **Indiana Gross Income Tax**: Inter-company Sales

Authority: IC 6-2.1-2-2, IC 6-2.1-5-5, IC 6-2.1-4-6, IC 6-8.1-5-4.

Taxpayer protests the Department's inclusion of inter-company sales in gross income.

II. **Indiana Gross Income Tax**: Proceeds from Asset Sales

Authority: I.R.C. § 338, I.R.C § 351, IC 6-2.1-2-2, IC 6-2.1-1-2, 45IAC 1-1-58, 45 IAC 1.1-6-2.

Taxpayer protests the Department's inclusion of proceeds from asset sales in gross income.

III. **Indiana Adjusted Gross Income Tax**: State Income Tax

Taxpayer protests the amounts of state income tax used to calculate gross income tax.

IV. **Indiana Adjusted Gross Income Tax**: Federal Taxable Income Adjustment

Taxpayer protests the Department's federal taxable income adjustment.

V. **Indiana Adjusted Gross Income Tax**: Payments

Taxpayer protests certain payments that were not refunded.

VI. **Indiana Gross Income Tax**: Out-of-State Sales

Authority: IC 6-2.1-2-2, IC 6-2.1-3-3, 45 IAC 1-1-120

Taxpayer protests the Department's inclusion of certain wholesale sales in gross income.

STATEMENT OF FACTS

Taxpayer is an international corporation engaged in the production and distribution of computers and computer equipment. A re-hearing was granted to resolve several issues relating to a 1990 to 1992 corporate income tax audit. Taxpayer has provided the Department with additional information pertaining to the issues. This Letter of Findings is based upon the Department's discussion with taxpayer at hearings, the information contained in the file, taxpayer's written brief, and the auditor's extensive notes in response to issues raised in taxpayer's original protest. More facts will be supplied as necessary.

I. Indiana Gross Income Tax: Inter-company Sales

DISCUSSION

The auditor disallowed the deduction of unsubstantiated inter-company receipts for the audit years. Taxpayer states that certain receipts represented inter-company sales.

"An income tax, known as the gross income tax, is imposed upon the receipt of...the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2. Also, IC 6-2.1-5-5 states in relevant part:

- (a) Corporations are affiliated if a least eighty percent (80%) of the voting stock of one (1) corporation (exclusive of directors' qualifying shares) is owned by the other corporation. Every corporation affiliated with another corporation is affiliated with every corporation that is affiliated with such other corporation. All corporations so affiliated constitute an affiliated group.
- (b) Corporate members of an affiliated group that are incorporated in the state of Indiana or are authorized to do business in the state of Indiana may file a consolidated gross income tax return.

IC 6-2.1-4-6 states:

- (a) Except as provided in subsections (b) and (c), each taxable year an affiliated group or corporations filing a consolidated return pursuant to IC 6-2.1-5-5 is entitled to a deduction from the gross income reported on such a return. The amount of the deduction equals the total amount of gross income received during the taxable year from transactions between members of the group that are incorporated or authorized to do business in Indiana.
- (b) The deduction provided by this section does not apply to gross income received by a member of an affiliated group and derived from sources outside Indiana.
- (c) The deduction provided by this section does not apply to gross income that is received by a member of an affiliated group in a distribution in connection with the dissolution of any other member of the affiliated group.

Also, IC 6-8.1-5-4(a) states that “[e]very person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person’s liability for that tax by reviewing those books and records.”

Taxpayer provided a spreadsheet to demonstrate where the figures they used for the returns originated. However, the deduction was disallowed because the figures were unsubstantiated. Taxpayer has not provided any documentation to verify the amounts used on the spreadsheet are correct.

FINDING

Taxpayer’s protest is denied.

II. Indiana Gross Income Tax: Proceeds from Asset Sales

DISCUSSION

During the audit, the auditor picked up additional receipts from the sale of fixed assets for 1991. The total adjustment is made up of two items: A drop-down of assets to a subsidiary corporation and an Indiana apportioned gain from an I.R.C. § 338(h)(10) disposition gain on fixed assets.

Gross income tax is imposed on the taxable gross income of a non-domiciliary or non-resident of Indiana if the income is derived from activities or sources within Indiana. IC 6-2.1-2-2. Gross income is defined in IC 6-2.1-1-2(a)(3) as gross receipts received “from the sale, transfer, or exchange of property, real or personal, tangible or intangible....”

First, Taxpayer contends that the auditor incorrectly included contributions of capital in receipts from a drop-down of assets to a subsidiary corporation. 45 IAC 1-1-58 states: “Contributions of capital to a corporation, joint venture or partnership are exempt from gross income tax. No gross receipts result to the recipient of the capital and none result to the donee upon his receipt of stock in exchange for the capital.” Taxpayer notes this section is consistent with I.R.C. § 351 and contends that only a percentage of the gain which is in excess of the property exchanged for the stock is taxable. I.R.C. § 351 states in relevant part:

- (a) General Rule.- No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation.
- (b) Receipt of Property. – If subsection (a) would apply to an exchange but for the fact that there is received, in addition to the stock permitted to be received under subsection (a). other property or money, than-
 - (1) gain (if any) to such recipient shall be recognized, but not in excess of-
 - (A) the amount of money received, plus
 - (B) the fair market value of such other property received; and
 - (2) no loss to such recipient shall be recognized.

....

Based on the information used to make the adjustment, sixty two percent (62%) of the realized gain was taxable pursuant to I.R.C. § 351(b). Consequently, this reduces the apportioned gross proceeds taxable by Indiana.

Second, Taxpayer asserts that the auditor included proceeds relating to an I.R.C. § 338(h)(10) transaction. I.R.C. § 338 states in relevant parts:

(a) GENERAL RULE. – For purposes of this subtitle, if a purchasing corporation makes an election under this section (or is treated under subsection (e) as having made such an election), then, in the case of any qualified stock purchase, the target corporation—

- (1) shall be treated as having sold all of its assets at the close of the acquisition date at fair market value in a single transaction, and
- (2) shall be treated as a new corporation which purchased all of the assets referred to in paragraph (1) as of the beginning of the day after the acquisition date.

...

(h) ELECTIVE RECOGNITION OF GAIN OR LOSS BY TARGET CORPORATION, TOGETHER WITH NONRECOGNITION OF GAIN OR LOSS ON STOCK SOLD BY SELLING CONSOLIDATED GROUP.

(A) IN GENERAL.- Under regulations prescribed by the Secretary, an election may be made under which if-

- (i) the target corporation was, before the transaction, a member of the selling consolidated group, and
- (ii) the target corporation recognizes gain or loss with respect to the transaction as if it sold all of its assets in a single transaction,

then the target corporation shall be treated as a member of the selling consolidated group with respect to such sale, and (to the extent provided in regulations) no gain or loss will be recognized on stock sold or exchanged in the transaction by members of the selling consolidated group....

However, in accordance with IC 6-2.1-1-2, the transaction is taxed as a stock sale. Nevertheless, 45 IAC 1.1-6-2(*formerly* 45 IAC 1-1-51) states in part:

(c) Receipts derived from an intangible are not included in gross income under the following situations:

- (1) The intangible forms an integral part of:
 - (A) a trade or business situated and regularly carried on at a business situs outside Indiana; or
 - (B) activities incident to such trade or business.

- (2) The intangible does not form an integral part of a trade or business situated and regularly carried on at a business situs in Indiana, and the taxpayer's commercial domicile is located outside Indiana.
- (3) The receipts from the intangible or otherwise excluded from gross income under IC 6-2.1-1-2 or 45 IAC 1.1-3-3(c)(7).
- (d) In determining whether an intangible forms an integral part of a trade or business or activities incident thereto under subsection (c), it is the connection of the intangible itself to such trade or business or activities incident thereto under subsection (c), it is the connection of the intangible itself to such trade or business or activities incident thereto that is the controlling factor. The physical location of the evidence of the intangible (share of stock, bond, etc.) is not a controlling factor. Also, any activities related to the sale of an intangible occur after the fact and are never determinative....

The stock does not form an integral part of trade or business regularly carried on at a business situs in Indiana. As such, it is not subject to the Indiana gross income tax.

FINDING

Taxpayer's protest is sustained.

III. Indiana Adjusted Gross Income Tax: State Income Tax

DISCUSSION

Taxpayer protests the Department's addback of certain state taxes during the audit. Taxpayer argues that certain tax amounts were added back that were not based on income. Taxpayer subsequently provided documentation dated January 10, 1997 which providing a description on the amounts to be used for the addback. Therefore, the audit should be adjusted to reflect these figures upon verification.

FINDING

Taxpayer's protest is sustained subject to audit verification.

IV. Indiana Adjusted Gross Income Tax: Federal Taxable Income Adjustment

DISCUSSION

Taxpayer protests an adjustment made to federal taxable income on its consolidated federal tax return. Taxpayer disputes the figure the auditor determined to be Taxpayer's 1992 Adjusted Federal Taxable income. The original adjustment was based on information supplied by Taxpayer during the audit. Taxpayer subsequently submitted a schedule that reconciled the variance in income between the federal schedules and that reported to Indiana. Taxpayer's protest is sustained.

FINDING

Taxpayer's protest is sustained.

V. **Indiana Adjusted Gross Income Tax**: Payments

DISCUSSION

Taxpayer protests a payment that was not credited toward its Indiana Corporate Income Tax. During the audit, the auditor relied on departmental records in calculating the credits. Although workpapers attached to the original return indicate Taxpayer was entitled to a refund, the Department has no record of the refund ever being sent to Taxpayer. Consequently, Taxpayer should receive credit.

FINDING

Taxpayer's protest is sustained.

VI. **Indiana Gross Income Tax**: Out-of-State Sales

DISCUSSION

Taxpayer is an out-of-state corporation who maintains sales offices and a repair facility in Indiana. Taxpayer sold personal computers and related hardware and software to Company A, an out-of-state corporation, who maintained a warehouse in Indiana. Taxpayer shipped these computers from an out-of-state location to Company A's Indiana warehouse. The auditor disallowed Taxpayer's exemption for these sales because Taxpayer did not provide sufficient information to show that these sales were in fact exempt.

Gross income tax is imposed upon "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2(a)(2). If the gross income is derived from business commerce between Indiana and another state, it is exempt from the gross income tax to the extent Indiana is prohibited from taxing that income by the United States Constitution. IC 6-2.1-3-3. Consequently, gross income "is not subject to the Indiana income tax unless the seller was engaged in business activity within the State and such activity was connected with or facilitated the sales". 45 IAC 1-1-120.

45 IAC 1-1-120(1)(b) describes a nontaxable in-shipment as:

Sales made by a nonresident who has a business situs or business activities within the State, but the situs or activities are not significantly associated with the sales, and the goods are shipped directly to the buyer upon receipt of a prior order... This situation arises most frequently...where a seller's home office, which is located outside Indiana, handles the accounts of some Indiana customers as "house accounts", instead of having such customers served by its in-state

employees. For the sales to be considered as nontaxable under this rule, they must be initiated, negotiated and serviced by out-of-state personnel, and contact with the Indiana business situs or with employees operating within the state must be no more than incidental.

Taxpayer has provided evidence that these sales were not connected with or facilitated by their Indiana business activity. Rather, they claim that the sales were handled as a “house account” by one of Taxpayer’s out-of-state offices dealing directly with Company A’s out-of-state office. Also, payments to Taxpayer were not paid by Company A from Indiana and were not received at Taxpayer’s Indiana offices. Contracts executing the sale of products were executed out-of-state. Taxpayer's out-of-state office maintained a team of six to eight people who were responsible for all sales, marketing programs and inventory management for Company A. Taxpayer established that all products sold to Company A were manufactured and stored out-of-state. Consequently, Taxpayer’s protest with regards to this issue is sustained.

FINDING

Taxpayer’s protest is sustained.